



137 Tenth Street, Parkmore  
Sandton, 2196  
Tel: (011) 666 0928  
Fax: (011) 666 0933  
Cell: 083 227-1375

“Creating BUSINESS sense out of BEE”

[info@caird.co.za](mailto:info@caird.co.za)

## CODE 100: FLOW THROUGH AND MODIFIED FLOW THROUGH PRINCIPLE

### Introduction

The Minister of Trade and Industry, Mandisi Mphahla, gazetted the Department of Trade and Industry's Broad-based Black Economic Empowerment Codes of Good Practice under section 9 of the Broad-based Black Economic Empowerment Act (2003) on the 9<sup>th</sup> of February, 2006. These codes are now binding on the state and numerous state-owned entities (covered in schedules 2 and 3 of the Public Finance Management Act).

This document is a synopsis of the pertinent aspects of the statement. Detail is available from the codes themselves.

Don't forget that at all times the definition of black people remains: A generic term for Africans, Coloureds and Indians who

- are South African citizens by birth or descent;
- are South African citizens by naturalisation before 27th April, 1994;
- became South African citizens after 27th April, 1994, but who, but for the Apartheid policy that had been in place prior to that date, would have been entitled to acquire citizenship by naturalisation prior to that date.

**An entity is defined as** - a natural or a juristic person, or any form of co-operative, conducting a business, trade or profession in the Republic of South Africa. When we refer to companies we are effectively referring to an entity as defined.

## Ownership scorecard

<b>Ownership. Total points - 23 (including 3 bonus points)</b>		
Description	Weighting points	Compliance Target
<b>Voting rights</b>		
Exercisable voting rights in the enterprise in the hands of black people.	3	25% + 1 Vote
Exercisable voting rights in the enterprise in the hands of black women.	2	10%
<b>Economic interest</b>		
Economic interest in the enterprise to which black people are entitled	4	25%
Economic interest in the enterprise to which black women are entitled	2	10%
Economic interest of the following black natural people in the enterprise <ul style="list-style-type: none"> <li>o black designated groups</li> <li>o black participants in employee ownership schemes</li> <li>o black beneficiaries of broad-based ownership schemes; or</li> <li>o black participants in co-operatives are entitled</li> </ul>	1	2.5%
<b>Realisation points</b>		
Ownership fulfilment	1	No restrictions
Net value	7	25%
<b>Bonus points</b>		
Involvement in the ownership of the Enterprise of black new entrants	2	10%
Involvement in the ownership of the enterprise of black participants <ul style="list-style-type: none"> <li>o in employee ownership schemes</li> <li>o broad-based ownership schemes; or</li> <li>o co-operatives</li> </ul>	1	10%

### Rights of ownership

A collective term for the right to economic interest and the right to exercisable voting rights. Therefore black ownership requires equal points for both voting rights and economic interest.

### Flow through principle

The rights of ownership in any entity must eventually end up in the hands of black natural people. The flow through principle tracks black natural ownership through multiple tiers.

#### Calculating the flow through principle

The rights of ownership are multiplied by the percentage of ownership throughout the tiers. For example:

Company A (40% black owned) owns 40% of Company B which in turn owns 80% of Company C.

The flow through principle would say that Company B is 16% black owned (40% of 40%) and Company C is 12.8% black owned (80% of 16%).

The flow-through applies to both voting rights and economic interest.

## **Modified flow through principle**

The modified flow through principle applies to any BEE owned or controlled company.

The definition of BEE owned and BEE controlled company is important here.

**"BEE controlled company"** means a juristic person, having share holding or similar members' interest in which black participants enjoy a right to EXERCISABLE VOTING RIGHTS that is more than 50% of the total such rights measured using the flow through principle.

**"BEE owned company"** means juristic person, having share holding or similar members' interest, that is BEE controlled, in which black participants enjoy a right to ECONOMIC INTEREST that is more than 50% of the total such rights measured using the flow through principle.

It follows that a BEE owned company is placed higher in the ownership hierarchy as this company enjoys both black voting rights and economic interest.

### **Application of the modified flow through principle**

Paragraph 3.3.2 is very clear that the modified principle ONLY applies to the calculation of voting rights of black people, and the economic interest of black people. This means that you cannot use the principle in calculating black-women voting rights and ownership or any other type of ownership (broad-based schemes etc) for that matter.

### **Calculating the modified flow through principle**

The principle allows a BEE-owned or controlled company in the tiers of ownership to be regarded as 100% black in one instance.

#### *Example 1*

Company A (51% black owned) owns 40% of Company B which in turn owns 80% of Company C.

The modified flow through principle would say that Company A is 100% black owned and Company B would therefore be 40% black owned (100% of 40%) and Company C is 32% black owned (80% of 40%).

### *Example 2 – Black controlled company*

Company A (black controlled company) owns 40% of Company B which in turn owns 80% of Company C.

The modified flow through principle would say that Company A has 100% black voting rights and Company B would therefore have 40% black voting rights (100% of 40%) and Company C has 32% black voting rights (80% of 40%).

The economic interest for this calculation would use the flow through principle.

### **Synopsis**

Code 100 and the definitions contained in schedule 1 seem to be quite clear that the modified flow through principle will determine the ownership of the company as this pertains to preferential procurement and enterprise development.

The score on the equity scorecard that this ownership attracts is a separate calculation and might not reveal as many points as the ownership would hint that it should.



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## **Caird**

To operate in today’s business environment requires a sharp eye. Business trends and legislation change so dramatically, that often companies may be left behind in coming to terms with these changes. Caird is a consultancy that finds the positive benefits in all these trends and translates them into business opportunities for its clients.

Broad-based BEE (B-BBEE) is one example. Caird firmly believes in its responsibility to ensure that its clients have a firm understanding of the concept and that they are able to isolate and implement the business opportunities and efficiencies that reside within B-BBEE.

Our BEE solutions combine well established methodologies with best practices that maximise the BBEE implementation.

## **Contact Caird**

Please feel free to discuss this document with us at any time.

Paul Janisch

Tel: (011) 666-0911

Email: [paul@caird.co.za](mailto:paul@caird.co.za)

Cell: 083 227-1375